



Inside This Issue

From the Director's Desk

An update on the commission and its activities from the director, Dee Jones Noordermeer.

Letter from the Chairman

Charlie Larkin writes on his past year as Commission Chair

New Licensees

Continuing Education Corner

Disciplinary Action

Case Law

The latest news court decisions from the Association of Real Estate License Law Officials.

Appraiser's Update

Mortgage Fraud: Confronting the Threat, Protecting the Profession

Earnest Money and Purchase Agreements

The Commission office was recently contacted to review a purchase agreement form to determine whether it substantially conforms to the purchase agreement prescribed by the State. The form in question states that the potential buyer has an unstated number of days following the effective dates in the contract to furnish the earnest money.

After review, it is the opinion of the Commission's legal council that this particular form does not substantially conform to the Commission's purchase agreement.

ARSD 20:69:17:01 requires that "A real estate purchase agreement prepared by a licensee must contain... an acknowledgment that earnest money was received." Additionally, SDCL 36-21A-80 requires that brokers who are retaining earnest money in their trust accounts must deposit the funds on the first legal banking day after the acceptance of the contract.

Only in a case of exceptional circumstances where the earnest money in a given transaction may not be immediately available, can the prescribed form be noted that the earnest money has not been tendered at the execution of the contract and will be tendered at a later date. In all other cases, the execution of the purchase agreement should provide for the immediate payment of earnest money.

All of the Commission's forms are available on the SDREC website at www.state.sd.us/sdrec. Questions regarding these forms can be directed to the SDREC office at (605) 773-3600.

Investment Properties: Know Your Tax Obligations

The do-it-yourself networks make it look easy. You purchase a fixer-upper, invest some sweat equity and a few dollars, then turn around and resell it for a profit. While investment properties are becoming a popular option, the Department of Revenue and Regulation reminds investors that once the construction and sale is complete, don't forget the tax paperwork.

Individuals who purchase and then sell investment properties have the same state tax liabilities as contractors who build or remodel property when the property is sold within four years of completion. Such individuals must get a contractors' excise tax license, which allows them to hire contractors to assist them as subcontractors on the renovation projects. Contractors' excise tax is then due on the selling price of the home.

For more information on how to obtain a contractors' excise tax license or what your tax obligations are for investment property situations, call the Department of Revenue and Regulation's toll-free helpline at 1-800-829-9188. Info is also available online at www.state.sd.us/drr.

A Letter from the Chairman



It's time to welcome the new Chairman of the Real Estate Commission, Brian Jackson. Brian is a lay member of the commission and a mortgage broker for Great Western Bank of Sioux Falls when he's not doing commission stuff. He was Governor Rounds' first appointee and has served the state well. He knows the banking business from the inside out and is a valuable asset to the commission.

So I get to say that it's been fun?? Enlightening??? Well, it certainly has been a learning experience!! We've accomplished a few things this last year that are worth remembering: Appointed Agency, CE Course of the Year for ARELLO (Meth). I was also elected to the ARELLO Board of Directors and serve on the finance committee along with a number of taskforces keeping SD abreast of all the latest trends in RE ahead of most states.

A final word of advice, not only to "newbie" licensees, but also for seasoned veterans – treat BOTH sides of the transaction honestly and fairly and you should never have to visit the Commission on a professional level, which is a good thing!

In all, it's been a great year in real estate, so thank a Commissioner the next time you see one. I would also like to thank all of the Commission office employees for making our jobs as Commission members so much easier. I'm not leaving the commission just yet but rather just going back to being one of the Guys (sorry Paula & Eileen, but you know what I mean). I'm looking forward to relaxing and participating in the hearings, not presiding over them. So adios and welcome Brian as the incoming Chairman.

P.S. A friend of mine once said that it is better to have been a "has been" than a never was! So get involved in your communities – take it from this has been, it is very satisfying to give something

back to the state that has given us so much.

Charlie

From the Director's Desk



Congrats to Paula Lewis and Charlie Larkin on being reappointed to the Commission! We can look forward to the next three years because of the knowledge these two broker members bring to the Commission. We are indeed fortunate to have such a strong Commission in place. Eileen Fischer, also an experienced broker, provides a wealth of knowledge to the Commission. In addition, Brian Jackson and Dennis Eismann have quickly grasped their responsibilities as public members. I assure you that all the Commission members take their appointments seriously and are dedicated to the mission of the Commission.

Speaking of the Commission, at its last meeting, the Commission gave its approval to move forward with the implementation of the broker simulation exam. The date to begin offering the new exam is yet to be determined. The State of Georgia is already utilizing this exam, so if you would like to get a better idea of what the questions are like, you can go to the testing company's website at www.goamp.com. From there, proceed as if you are a Georgia candidate. Since SD initially licenses broker associates instead of salespersons, the exam will be given in two sessions. One session will be a multiple choice exam consisting of entry level national and state specific items. The other session will contain the broker simulation items.

Commission member Paula Lewis, auditor/investigator Michelle Metzinger and I recently attended the annual conference of the National Land Council. Of particular interest were the topics on condo hotels and nonequity clubs. This conference was originally planned for last

October but because of Hurricane Rita, it was postponed until May. In spite of this, the Halloween costume party remained on the agenda. Much to our surprise, South Dakota won the "Most Original" category! Since there were a total of five South Dakotans in attendance, we portrayed ourselves as Mt. Rushmore and Gutzen Borglum. Several people commented that they had never been to South Dakota, but now want to come visit our great state.

Two bills that fall under the real estate brokerage act, will become law on July 1, 2006. House Bill 87 amends SDCL 36-21A-71 to require a broker to obtain prior written consent to advertise or market property on behalf of an owner. House Bill 155 amends SDCL 36-21A-46.1 to permit salespersons and broker associates within the same firm to form a business corporation or limited liability company for the sole purpose of receiving a commission.

A reminder for you brokers — if an associate is transferring to another broker and has given you the change of association form to sign, don't return that associate's license to the Commission. When a license is returned to the Commission, the licensee is placed on inactive status and that individual cannot engage in any activities requiring a real estate license. Also, for those of you requesting the licenses of new licensees, please be patient. Sometimes it can take up to two weeks to process a license, especially in cases where the application is not completed or is missing required documents.

There appears to be a concern regarding counteroffers. Licensees have informed me of not receiving counteroffers back that have been rejected. It is good practice that if your client rejects a counteroffer to have your client acknowledge the rejection in writing and return a copy of this to the agent representing the party who initiated the counter. Obtaining a written acknowledgment of the rejection is a risk reduction tool because it provides proof that the counter was actually presented.

I wish all of you a wonderful Fourth of July as you celebrate living in the "land of the free and the home of the brave."

DjN

New Licensees

The SD Real Estate Commission would like to welcome the following new licensees.

Broker

Crabtree, Carole F – Brunswick, NE
Frykman, Nancy L – Edina, MN
Helm, Robert W – Jackson, WY
Honer, Lorinda E – Graceville, MN
Hook, John R – Redstone, CO
Rosfeld, Philip J – Chadron, NE
Williams, Dean C – Tulsa, OK

Broker Associate

Aesoph, Levi – Brookings
Ailts, Verlin – Yankton
Allex, Timothy – Sioux Falls
Anderson, Brittany J – Sioux Falls
Anderson, Chad A – Doland
Antonie, Nicholas A – Mitchell
Aumann, Peter S – Rapid City
Benker, Megan L – Brandon
Bierschenk, Timothy J – Dell Rapids
Brenneman, David S – Black Hawk
Brost, John C – Rapid City
Cameron, Terry L – Brandon
Clark, Dorette – Watertown
Couch, Janelle “Louanne” – Keystone
Culbertson, Jay S – Burbank
Doornink, Kathy – Belle Fourche
Dunford, Teresa A – Yankton
Dyce, Arlyn J – Rapid City
Fiedler, Jody L – Watertown
Freese, Lesly A – Belle Fourche
Fritz, Barbara A – Rapid City
Gilmour, Tim – Watertown
Gullikson, Charmaine M – Wakonda
Hagen, Andra J – Rapid City
Haggerty, Jr., John J – Rapid City
Hegre, Richard D – Rapid City
Henneman, Eric L – Lead
Huether, Carol – Rapid City
Hutchinson, Brock – Sioux Falls
Jacquot, Daneen M – Rapid City
Jones, Melanie – Britton
Keil, Ronald – Belle Fourche
Knutson, Katrina J – Brookings
Kraft, Melissa A – Belle Fourche
Kronenberg, Peter W – Rapid City
Kuehn, Julie K – Watertown
Kuiper, Matthew R – Sioux Falls
Lalim, Kyle A – Watertown
LaQua, Michael L – Sioux Falls
Larsen, Donald J – Sioux Falls
Mahoney, Ben B – Spearfish
McDowell, Joel – Harrisburg
McMaster, Danelle – Aberdeen

Miller, Walter B – New Underwood
Monnens, Timothy “Tim” A – Vale
Olson, Kristyn L – Harrisburg
Olson, Rachel D – Fort Pierre
Owen, Sue E – Rapid City
Pallatto, Barbara J – Rapid City
Randolph, Nancy – Hill City
Schaefer, Jacqueline K – Watertown
Simonson, Marie S – Madison
Stojack, Linda L – Deadwood
Storm, John R – Vermillion
Swingler, Sandra F – Aberdeen
Tesch, Joseph J – Watertown
VanderLoo, Shane J – Sioux Falls
VanDerWerff, Mark A – Armour
Varland, Alan L – Lead
Wade, Clifford M – Rapid City
Washnok, Patricia R – Brandon
White, Keith M – Rapid City
Wojtanowicz, Terrance J – Rapid City
Yetman, Larry A – Sioux Falls
Yetman, Tami K – Sioux Falls

Auctioneer

Dunlavy, Robert R – Watertown

Res. Rental Agent

Burk, Richard D – Sioux Falls
Conley, Laurie L – Watertown
Eliason, Shannon R – Belle Fourche
Gardner, Channele – Sioux Falls
McGreevy, Susan S – Sioux Falls
Moore, Bryan – Sioux Falls
Murphy, Deborah K – Sioux Falls
Steen, Rose M – Watertown

Salesperson

Baxter, Randy M – Ainsworth, NE
Birkley, Lowell A – Jackson, NE
Dougherty, Travis – Chambers, NE
Johnson, June A – Sundance, WY
Nitz, James V – Ortonville, MN
Small, Carolyn L – Salix, IA
Strobl, Matthew L – Delano, MN
Trebelhorn, Brian – Northfield, MN
Tucker, Lacosta J – Strawberry Plains, TN

Timeshare Agent

Bucholz, Karen J – Lead
DuBray, Kimberly R – Rapid City
Hopkins, Jamie – Lead
Jandreau, Michael J – Rapid City
McCurdy, Betty – Casper, WY
Stucker, Jon (Scott) – Rapid City
Welch, Cody A – Rapid City

Reg. Home Inspector

Buhl, Kim J – Pierre
Hegdahl, Wayne A – Pickstown
Lawrence, Tim S – Mitchell

Licensed Home Inspector

Johnson, Scott M – Sisseton

Mortgage Fraud: Confronting the Threat, Protecting the Profession

See Article in Appraiser's Section of
Newsletter

South Dakota Real Estate VIEW

Official Publication of the
South Dakota Real Estate Commission
221 West Capitol Ave., Suite 101
Pierre, South Dakota 57501

Telephone: 605-773-3600

Facsimile: 605-773-4356

Website: www.state.sd.us/sdrec
E-mail: dr.ralestate@state.sd.us

Editor-in-Chief: Dee Jones

Noordermeer

Editor: Karen Callahan

THE COMMISSION AND STAFF

Charles Larkin, Chairman.... Watertown
Brian Jackson, Vice-Chair... Sioux Falls
Eileen Fischer, Member..... Pierre
Dennis Eisnach, Member Pierre
Paula Lewis, Member Rapid City
Dee Jones Noordermeer,
Executive Director Pierre
Karen Callahan,
Education Director. Pierre
Norma Schilling, Licensing..... Pierre
Michelle Metzinger, Auditor..... Pierre
Tim Buseman, Auditor Sioux Falls

Articles by outside experts express the author's particular viewpoints. These opinions are not necessarily shared by the Commission, nor should they be mistaken for official policy. The articles are included because they may be of interest to the readers.

Latest Court Decisions

The following case reports are from the Association of Real Estate License Law Officials (ARELLO) 2005 Annual Case Law Report

Buyers' Deposit Held Hostage for Commission

Hayber v. Department of Consumer Protection, 866 A.2d 644 (2005)

Facts: Hayber, a licensed real estate broker, was retained by two sellers to market their property and entered into a exclusive right to sell contract. The contract required the sellers to pay the broker a commission if he found a buyer ready, willing, and able to purchase the property. Hayber found buyers who entered into a sale and purchase agreement with the sellers. The agreement designated Hayber as escrow agent for the transaction. The buyers deposited \$16,000 with Hayber to be held in escrow and as liquidated damages if the buyers backed out of the agreement. The buyers subsequently informed the sellers that they would not perform under the agreement. The buyers and sellers agreed to split the \$16,000 between themselves and instructed Hayber accordingly. Hayber refused to release the funds until he received a brokerage commission. After an administrative hearing, the Department ordered Hayber to remit the escrow deposit, plus interest, and to pay a civil penalty.

Issue: Whether a broker who holds funds as an escrow agent may refuse to release those funds in order to assert his claim for a sales commission.

Held: Affirmed. The court found that Hayber's claims had no merit and that he had breached his fiduciary duties as escrow agent by withholding the escrowed funds.

Fair Housing Responsibility of Supervising Broker

Holley v. Crank, 400 F.3d 667 (2005) U.S. Court of Appeals for the 9th Circuit

Facts: The Holleys are a mixed-race couple. They allege that in October 1996, they visited Triad Realty's office in Twenty-Nine Palms, California, where

they met with agent Crank. The Holleys inquired about listings for new houses in the range of \$100,000 to \$150,000. Crank showed them four houses in the area, all priced above \$150,000. In mid-November 1996, the Holleys located a home on their own that was listed by Triad. In response to the Holley's inquiry about the home, Triad agent Stump informed them that the asking price for the house was \$145,000. The Holleys expressed interest in purchasing the home and offered to pay the asking price and agreed to put \$5,000 in escrow for the builder to hold the house until April or May, 1997, when they closed on the sale of their existing home. Later, Stump called the Holleys to tell them that more experienced agents in the office, one of whom was Crank, felt that \$5,000 was insufficient to get the builder to hold the house for six months. The Holleys decided not to raise their offer and Triad never presented it to the builder. One week later, the builder inquired at Triad about the status of the Holley's offer. Crank then allegedly used racial invectives in referring to the Holleys. The builder later sold his house for approximately \$20,000 less than the Holleys had offered.

Issue: Whether the owner of Triad can be held vicariously liable for the salesman's violations of the Fair Housing Act ("FHA") based on the owner's status as the designated officer/broker.

Held: The court held that when the firm owner, who was personally responsible for the supervision of the company's employees, delegated such responsibility to the salesman, he created an agency relationship between himself and the salesman that made him vicariously liable for the salesman's discriminatory actions.

Continuing Education Corner

By Karen Callahan, Education Director

Did you know that continuing education credit may be earned for courses taken outside of South Dakota? Out-of-state courses are generally accepted for credit in SD provided that the course is approved by the Real Estate

Commission in the state the course is given.

To receive credit for an out-of-state course, licensees must submit an Out of State Credit Application Form to the SDREC office. This form is available on the SDREC website, under "Forms and Supplemental Guides". A copy of the course completion certificate as well as a course outline must accompany this form.

Disciplinary Action

The following disciplinary actions have become effective since the last report in the newsletter, excluding cases currently on appeal. A Stipulation and Assurance of Voluntary Compliance is a settlement agreement between licensees and the Real Estate Commission and constitutes neither an admission nor a denial of any violation.

James Cadet Oxandaburu, Sioux Falls, Broker. Findings of Fact, Conclusions of Law, and Order. Revocation of license. Violation of SDCL 36-21A-71 (6), Conviction of a felony.

Allen Nouis, Belle Fourche, Broker Associate. Findings of Fact, Conclusions of Law, and Order. Pay a penalty of \$250 and costs of \$3,633.04. Violation of SDCL 36-21A-71(3), (31), (32), (33) and SDCL 36-21A-136.



In Memoriam

The SD Real Estate Commission extends its sincerest sympathy to the families and friends of the following licensee who recently passed away:

Jonathan Downs, Sioux Falls
Kenneth Schlichte, Merrill, IA

APPRAISER UPDATE

This section of the South Dakota Real Estate Review is the responsibility of the South Dakota Department of Revenue and Regulation Appraiser Certification Program. Articles are printed here to communicate pertinent information to those appraisers who receive this newsletter and are licensed under the Certification Program. Appraiser certification inquiries can be directed to Sherry Bren, Program Administrator, 445 East Capitol, Pierre, SD 57501, 605-773-4608.

Appraiser Certification Program Mission-Purpose- Intent

The Appraiser Certification Program was implemented July 1, 1990, pursuant to enactment of Title XI of the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA) by Congress. The mission of the Program is to certify, license and register appraisers to perform real estate appraisals in the State of South

Dakota pursuant to Title XI (FIRREA). The purpose of the Program is to examine candidates, issue certificates, investigate and administer disciplinary actions to persons in violation of the rules, statutes and uniform standards, and approve qualifying and continuing education courses. Title XI intends that States supervise all of the activities and practices of persons who are certified or licensed to perform real estate appraisals through effective regulation, supervision and discipline to assure their professional competence.

Appraiser Certification Program Advisory Council

Council members provide recommendations to the Secretary of the Department of Revenue and Regulation in the areas of program administration in order to sustain a program that is consistent with Title XI. The Council meets quarterly in public forum. See the Website for meeting information. www.state.sd.us/appraisers

Administrative Rule Changes

Key revisions and a complete set of the Administrative Rules regarding appraisers are available on the Appraiser Certification Program Website: www.state.sd.us/appraisers.

USPAP Q & A

Vol. 8, No. 4, April 2006
Including an "Unreliable" Approach to Value

Question: I have a client requesting that the cost approach be included in every appraisal assignment, including those where I feel the cost approach may not yield meaningful results. I am concerned that by complying with the client's request I may be providing a misleading appraisal report. How can I comply with USPAP and satisfy the client at the same time?

Review Appraiser Bias

Question: An appraiser receives a request to review an appraisal; however, the reviewer has previously appraised the same property. Does the reviewer's prior experience with the property create a bias that then precludes an objective review?

Appraiser's Fees

Question: I'm aware that an appraiser's fee cannot be based on the amount of the appraiser's value conclusion. However, does USPAP allow an appraiser's fee to be based on the amount of the owner's estimate or a pending sale price of the subject property?

Vol. 8, No. 5, May 2006

Appraisers "Providing Comps"

Question: I have a client that just wants me to "provide comps" from a neighborhood. Are there any USPAP requirements I must comply with to perform this task?

Business Valuation Using Asset- Based (Cost) Approach

Question: I am valuing a controlling interest in a business enterprise by use of an asset-based (cost) approach, and that business owns real property. Am I required to have an appraisal of the real property or may I use other indications of the real property value?

Answers to the above questions can be found at:

www.appraisalfoundation.org

New Licensees – April/May

Kevin M. Krull, State-Registered – Crooks, SD

Richard D. Hauge, State-Certified General – Redwood Falls, MN

Amy J. Kirchhevel, State-Registered – Brookings, SD

Jerad L. Rokusek, State-Registered – Sioux Falls, SD

William J. Moran, State-Certified General – Hyannis, MA 02601

Joshua W. Luther, State-Registered – Sioux Falls, SD

Rodney D. Johnson, State-Certified General – Norfolk, NE

Dawn N. Puckett, State-Registered – Hermosa, SD

Review of Cases – January 1, 2006 through May 17, 2006

For the period January 1, 2006 through May 17, 2006 the Department has received 9 upgrade applications and initiated 10 complaints.

Upgrades – 5 pending; 3 issued; and 1 agreed disposition

Complaints – 6 pending; 3 disciplinary actions; and 1 closed, no action.

2006 Renewal

The 2006 renewal applications will be mailed the first week in July. In order to renew your certificate for state-certified general, state-certified residential, state-licensed and state-registered appraiser you must submit the completed application, applicable renewal fees by August 17, 2006.

Appraisal Regulations and the Interagency Statement on Independent Appraisal Evaluation Functions

(Continued from the December/January and February/March issues of *The Real Estate View*)

March 22, 2005

The Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision and the National Credit Union Administration (the agencies) prepared this document in response to questions from federally regulated institutions (regulated institutions) on existing standards for selecting appraisers, ordering appraisals, accepting transferred appraisals, and other related topics. It should be reviewed in conjunction with the agencies' appraisal regulations, the "Interagency Appraisal and Evaluation Guidelines" (interagency guidelines), dated October 7, 1994, and the joint statement "Independent Appraisal and Evaluation Functions" (independence statement), dated October 28, 2003.

Evaluation and Other Appraisal Topics

22. Can an otherwise qualified individual prepare an evaluation of a property securing a loan that will be approved by his/her direct supervisor? Can one officer perform an evaluation for another if they are both members of a loan committee, provided the evaluating officer abstains from voting? Could the lending officer or branch manager in a small, regulated institution perform the evaluation

if he/she abstains from the final loan approval?

Answer: To maintain independence, the individual preparing an evaluation should not directly report to someone involved in loan production. In a small, regulated institution where absolute lines of independence cannot be achieved, one officer may perform an evaluation for another as long as the evaluating officer abstains from the lending decision.

23. Do the interagency guidelines apply only to loans in excess of \$250,000? Is the \$250,000 threshold the loan amount or the property value?

Answer: The interagency guidelines apply to all real-estate-related financial transactions regardless of size or whether loans are for a regulated institution's own portfolio, held for sale, or held in asset-backed conduits. However, the agencies' appraisal regulations allow regulated institutions to use an appropriate evaluation of the real estate in lieu of an appraisal for transactions with a value of \$250,000 or less, business loans \$1 million or less, or subsequent transactions (transactions involving an existing extension of credit at the lending institution). The regulations define transaction value as the amount of the loan or extension of credit, not the value of the property. The interagency guidelines contain minimum standards for evaluation content and address the qualifications of individuals performing evaluations.

[Note: NCUA's business loan evaluation threshold is \$250,000 or less. (12 CFR Part 722.3(b)(2))]

[FDIC FIL-20-2005: Frequently Asked Questions. See

<http://www.fdic.gov/news/news/financial/2005/fil2005a.html>]

Mortgage Fraud: Confronting the Threat, Protecting the Profession

By Claire Nicolay

[The following article originally appeared in *Valuation Insights & Perspectives* (First Quarter 2006). Copyright. Appraisal Institute. All rights reserved. Reprinted by permission.]

The housing market boom, increased mortgage activity, urban renewal and insufficient industry regulation have all contributed to the rise of mortgage fraud in the United States. With reported mortgage fraud losses more than doubling in the last year – from \$429 million in 2004 to over \$1 billion in 2005, according to Federal Bureau of Investigation statistics – the crisis has spurred a variety of responses.

The FBI has set up several stings including "Operation Quick Flip," which increased collaboration with other government and industry entities; the appraisal profession has pushed for increased oversight and regulation of appraisers; the Responsible Lending Act (H.R. 1295) has been introduced; increased state-level legislation is occurring; and banks and lending institutions have initiated preemptive responses against potential fraud.

The many faces of fraud

Mortgage fraud falls into three major categories: fraud for property (consumer fraud), commission fraud, and fraud for profit. This last category, fraud for profit, comprises the vast majority of mortgage fraud and is the FBI's primary target. Mortgage fraud today has led to an upturn in pressure, inflation, flipping and identify theft, all of which can directly affect appraisers. Thus, although appraisers are not at the center of the mortgage fraud epidemic, they still need to be fully aware of the changing nature and scope of this threat.

The FBI has determined the chief mortgage fraud indicators to be:

- Exclusive use of one appraiser;
- Increased commissions and/or bonuses to brokers and appraisers (including bonuses for fee-based services and higher fees);
- Misrepresentations on loan applications, often with the buyer taught how to falsify the application or even asked to sign a blank application;
- Fake supporting loan documentation, often with the buyer being asked to sign blank employee, bank or other forms;
- Purchase loans disguised as refinance, which require less oversight; and
- The use of short-term investments with guaranteed repurchase, with the

use of investors to flip property for fixed percentages or multiple “holding companies” to increase property values.

Although these practices aren’t new, the FBI sees increased sophistication in their implementation. According to a May 2005 report, “An educated criminal element ... is using identity theft, straw borrowers and shell companies, along with industry insiders to conceal their methods and override lender controls.”

The Appraisal Institute has been actively involved in the fight against mortgage fraud and instrumental in the drafting of H.R. 1295, the appraisal profession’s strongest hope to reduce mortgage fraud and its influence on appraisers. Informed by research and testimony from the Appraisal Institute, as well as from other industry organizations, H.R. 1295 was introduced before Congress in 2005, and is expected to proceed to the House Committee on Financial Services for hearings later this year.

In Congressional testimony in support of H.R. 1295, Appraisal Institute past president, Alan E. Hummel, SRA, delineated the major problems from the appraiser’s point of view: third-party pressure on appraisers to meet predetermined values, inadequate oversight of appraisers by regulators and the general need to improve appraisal quality. The answers to these problems, Hummel testified at a joint hearing by the Subcommittee on Financial Institutions and Consumer Credit and the Subcommittee on Housing, are reform of the appraising regulatory structure, funding for state oversight and enforcement, and increased appraisal quality and professionalism.

Recent federal responses

As mortgage fraud complaints reached an all-time high in 2005, the FBI responded with Operation “Quick Flip,” a joint operation of the IRS, the Department of Housing and Urban Development, the U.S. Postal Inspection Service and the Department of Justice. Quick Flip targets mortgage fraud groups to “disrupt and dismantle them permanently,” according to a December 2005 press release. The FBI acknowledges the wide range of fraud schemes, but has declared its intention to focus on industry insiders, who are involved in 80 percent of mortgage fraud schemes.

The federal government has also responded to specific mortgage fraud situations. For example, in December 2004, the Department of Justice accused Fannie Mae of knowingly accepting money that had been lost by the Government National Mortgage Association (Ginnie Mae) in a fraud scheme involving the First Beneficial Mortgage Corp., Olympia Mortgage Corp., and United Homes, LLC. Although Fannie Mae did not admit to any wrongdoing, it agreed to pay \$7.5 million to the Justice Department, according to a February 2005 article in *Realty Times*. Fannie Mae’s involvement in this matter was cited by HUD’s Office of Federal Housing Enterprise Oversight in a 2005 regulation designed to increase accountability at both Fannie Mae and Freddie Mac. This rule requires both institutions to report mortgage fraud or possible mortgage fraud in a timely fashion and requires them to establish internal controls, procedures and training programs to detect and report mortgage fraud.

In another significant development, Ameriquest Mortgage Co. has agreed to change its appraisal ordering procedures as part of a \$325 million settlement of a case in which the company was accused of deceiving borrowers, using high-pressure sales tactics, falsifying loan documents and pressuring appraisers to overstate home values. Ameriquest will now be required to centralize property appraisals so loan officers can’t influence appraisers to inflate home values. The lender will also use outside agents to close mortgages to ensure borrowers aren’t pressured by loan agents into signing final papers. Ameriquest must also appoint an independent monitor to ensure compliance and install new rules that compel loan agents to clearly disclose mortgage terms to customers during the approval process. According to *Appraiser New Online*, all companies involved in the Ameriquest case “specialize in higher-cost mortgages to borrowers unable to qualify for bank loans, prompting industry analysts to speculate that rival companies in the subprime market will be driven to adopt similar standards to avoid legal challenges from regulators and consumers.”

Actions in the states

Although 26 states have been identified as having serious mortgage fraud problems, the FBI has listed 10 states as

mortgage fraud “hot spots”: Florida, Georgia, Illinois, Michigan, Missouri, South Carolina, Colorado, Utah, Nevada and California. While the FBI cites Florida and Georgia as having the highest incidence of mortgage fraud, information service provider Mortgage Asset Research Institute has spotted a slightly different trend shift. In testimony before the House Subcommittee on Housing and Community Opportunity, William Matthews, vice president of MARI, stated: “Georgia and Nevada have caught up to and surpassed California and Florida as the states with the highest fraud scores.”

The rapid rise of foreclosure rates is an important indicator of mortgage fraud. In January 2006, RealtyTrac released figures that show the overall U.S. foreclosure rate heading toward new highs. Florida had a 25 percent increase of new foreclosures over the course of 2005; Georgia, Arizona, Indiana, New Jersey and Ohio were close behind. In response to North Carolina’s rising foreclosure rate, state lawmakers are proposing to make appraisers’ and brokers’ names available to the public so authorities would be able to track similarities or patterns in loans that go to foreclosure. Presumably, other states will follow with similar solutions.

Some states are in the process of creating laws that would make mortgage fraud a criminal act. In 2005, Georgia responded to its mortgage fraud crisis by passing S.B. 100, the Georgia Residential Fraud Act, which specifies mortgage fraud as a felony offense and establishes penalties. New Jersey has legislation currently in progress (S.B. 456) that would make residential mortgage fraud a separate crime.

Despite such examples of legislative progress, however, individual states are hampered in their pursuit of mortgage fraud perpetrators by insufficient legal tools, fraud information and funds. However well designed, laws can’t make a difference without money to enforce them. Thus, H.R. 1295 could provide crucial back-up for states: in addition to granting the Appraisal Subcommittee more enforcement tools, it requires the federal committee to fund grants to state appraisal boards.

Industry responses

As the federal government has tightened mortgage fraud surveillance with

Careful focus on mortgage fraud indicators, so banks and lending institutions have begun to take precautionary measures against mortgage fraud. For example, Freddie Mac instituted a program of data mining to find fraud patterns to preempt delinquent loans. Indeed, the government is following suit. According to Lew Sichelman of *Realty Times*, "Prosecutors are no longer waiting for losses to occur before going after swindlers who cheat lenders and investors out of billions of dollars annually."

MARI maintains a cooperative database called the Mortgage Industry Data Exchange (MIDEX) for the residential mortgage and financial services industries. MIDEX contains information on nonpublic incidents of alleged fraud, material misrepresentation and serious misconduct in the mortgage industry, public sanctions and legal actions collected from federal and state legislators, and state and federal licensing data for the mortgage and commercial banking industry. For more information, visit www.mari-inc.com/.

The Appraisal Institute's research for and advocacy of H.R. 1295 has been its

strongest response to the mortgage fraud crisis. However, the Appraisal Institute has also taken other steps: its Appraiser Independence Action Center (available at www.appraisalinstitute.org/govtaffairs/appraiser-independence/cmplnt_cntr.asp) helps appraisers to combat client pressure by directing their complaints against a lender, mortgage broker, realty agent or other appraisers to the appropriate authorities. Also, the organization's online newsletter, *Appraiser News Online*, offers easy access to all breaking industry news.

In addition, for several years the Appraisal Institute has called for an industry-wide "best practices" statement that would help lenders, real estate agents, appraisers and others "better understand and remedy this abusive practice," according to Don Kelly, vice president of Public Affairs for the Appraisal Institute.

Other nonprofit groups like Demos and the National Community Reinvestment Coalition have also offered solutions to mortgage fraud. In 2005, NCRC founded its Center for Responsible Evaluations and Appraisal, which developed a code of

conduct that includes acceptance of a dispute resolution procedure developed with the American Arbitration Association. According to John Taylor, president and CEO of NCRC, this model will give signatories "an inexpensive, quick, independent, and fair method of resolving complaints against those who have allegedly violated the code of conduct."

Kelly added, "Pressure on appraisers from someone with an interest in the transaction to deliver appraisal reports that shade or misrepresent the value of a property or its condition is the single greatest threat to the integrity of the mortgage lending process. Because of this, the efforts of the NCRC to call attention to and address the issues of client pressure should be taken seriously." Currently, the Appraisal Institute is working with NCRC to refine its approach to deal with this issue, according to Kelly.

Ultimately, increased government, industry and consumer attention should help reduce the mortgage fraud rate. The financial health of U.S. consumers and the efficiency of the marketplace depend on it.

4020 copies of this publication were printed by the SD Real Estate Commission at a cost of .22 per copy

SD Real Estate Commission
221 W Capitol Ave, Suite 101
Pierre, SD 57501